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Some Implications of the Changing US Current Account Position

The shift in the US current account position from a surplus to a deficit now underway signals significant changes in the nature of US international economic concerns during the next year or so. During that period:

-- US export performance will suffer.

-- The dollar will weaken especially against the yen and the mark.

-- US trade frictions with other developed countries could well increase, especially with Japan which could be running a record current account surplus in 1982 of as much as $30 billion.

-- US economic performance will have to depend increasingly on domestic based growth.

-- US inflation will be boosted by the higher prices of foreign goods. Although the initial inflationary impact will result from higher prices of imported manufactures, the major upward price pressures will likely come from the increased ability of US manufactures to push up its prices and still remain competitive with foreign goods.

These changes in the US trade and payments position and in the related policy concerns must be considered inevitable. They are a natural reflection of the movement toward free-floating exchange rates and the more exaggerated business cycle that have taken place since the early 1970s. In fact, in accepting the considerable benefits of the much less regulated global financial system, policymakers have had to accept the inevitability of constant self-correcting swings in foreign payment patterns. It is impossible, however, to gauge with any precision the timing or magnitude of these changes, or their impact on domestic policy endeavors. What can be done is to forewarn policymakers as to the nature and possible implications of the changes underway and to closely monitor the unfolding conditions.

Among the key factors affecting the magnitude of the current account shift are the degree of US loss in export competitiveness and the difference in economic growth between the United States and its major trading partners. The US share of developed country exports peaked around mid-1981 and will likely deteriorate through at least mid-1982. US economic growth next year is now envisioned to top the composite of other OECD countries by about one-half a percentage point. If, however, the US economy does not perk up much in the first half of 1982, US growth would likely fall below other OECD countries, and thus the current account slippage may be small. Most experts now believe that the US current account position will move from near a $5 billion surplus in 1981 to a deficit ranging from $5 billion to $20 billion in 1982, mainly depending on how fast the United States does grow next year.

Although a slippage in the US current account position tends to undermine the strength of the dollar, the degree to which the dollar will deteriorate is particularly uncertain. Continuing high US interest rates and political uncertainties in eastern and western Europe are working to sustain the dollars' value. The longer that such factors favor dollar investments, however, the longer it will take for the United States to once again recoup its competitive pricing edge in international trade. The fundamental factors influencing price competitiveness will continue to assist the Japanese and Germans. Their inflation rates are expected to run below those in the United States (as they have for several years), and these two countries are likely to continue to enjoy faster growth in productivity in the manufacturing sector than the United States. As a result, the longer the dollar maintains its strength, the larger of a cut in the dollars' value will be needed to restore the price competitiveness of US goods.

From a European or Japanese perspective, the initial impact (lasting for a year or so) of a deterioration in the US current account position and the dollar would be largely positive. They would benefit from the increased global market shares acquired in head-on competition with the United States, the rapid expansion of the US market, and the lower prices they pay for imported US manufactures and those basic commodities priced in dollars, such as crude oil.

By late next year, the United States and its major trading partners could face policy differences stemming from:

-- Increased protectionist sentiment, especially in Europe, as a consequence of the competitive edge the

United States would be gaining as a result of an erosion in the value of the dollar.

-- A buildup in foreign pressure against the United States to boost the dollar through higher interest rates.